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IN THE

Supreme Court of the United States

October Term, 1974

No. 74-1198

EDWIN R. MacKETHAN, Receiver of Norfolk Savings and Loan Corporation,

Petitioner,

v.

COMMONWEALTH OF VIRGINIA,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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FORM OF REFERENCE

App. ..... refers to page number of appendix attached to the Petition.

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I.

STATEMENT OF RELEVANT FACTS

The statement of facts must necessarily be those set forth in the Complaint, which even though not admitted by the Commonwealth of Virginia (hereinafter "Commonwealth") to be true, were taken as pleaded for purposes of the Motion to Dismiss in the District Court. Those additional facts alleged in the Petition, although doing nothing to affect the legal conclusion reached by the District Court and the Fourth Circuit, are irrelevant surplusage for purposes of this appeal.

The Complaint discloses that the court-appointed Receiver of Norfolk Savings and Loan Association (hereinafter "Norfolk Savings"), an industrial loan association created pursuant to the laws of the Commonwealth,[1] is suing the

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[1] See, Title 6.1, Chap. 5, § 6.1-227, *et seq.*, of the Code of Virginia (1950), as amended.

Commonwealth in federal court, jurisdiction being founded upon the Securities Act of 1933[2] and the Securities Exchange Act of 1934 (hereinafter " '33 and '34 Acts"). Paragraphs 4 and 5 of the Complaint allege that "Certificates of Investment" issued by Norfolk Savings were "Securities" within the meaning of the '33 and '34 Acts and entitled to "investor protection" afforded by the '34 Act. All allegations are based on violations of Section 10(b) of the '34 Act [15 U.S.C. § 78j(b)] and Rule 10(b)-5 adopted thereunder. No specific reference is made to any violation of any section of the '33 Act. There is no allegation concerning the common stock of Norfolk Savings or any other instrument than "Certificates of Investment" evidencing transactions between Norfolk Savings and its depositors.

Norfolk Savings was regulated by the Virginia State Corporation Commission (hereinafter "Commission") whose duties were generally to supervise and examine it as provided in Chapter 5 of Title 6.1 of the Virginia Code. There is no allegation that the Commission operated Norfolk Savings, offered or sold any securities, nor registered any securities Norfolk Savings may have issued.[3] The Complaint alleges in extraordinarily general terms that the insolvency of Norfolk Savings was the result of the fraudulent and/or negligent state supervision of Norfolk Savings. (Complaint, paragraph 11).

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[2] Paragraph I of the Complaint incorrectly refers to the Securities Act of 1933 as the Securities Exchange Act of 1933. No violations of any sections of this Act appear to be alleged on the face of the Complaint which makes the founding of jurisdiction thereon a useless gesture.

[3] As a matter of fact, securities of industrial loan associations are exempted from registration under Virginia law by Va. Code § 13.1-514(6).

II.

ARGUMENT

A.

Federal Jurisdiction

This suit attempts to invoke federal jurisdiction over the Commonwealth to obtain damages to be paid from the public treasury, liability being based upon fraudulent and negligent state regulation. Such an action is prohibited by the Eleventh Amendment to the United States Consitution which provides:

> The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by citizens of another State, or by Citizens or Subjects of any Foreign State.

It is similarly well established that an unconsenting state cannot be sued in federal court by its own citizens. *Hans* v. *Louisiana,* 134 U.S. 1, 10 S.Ct. 504 (1890); *Duhne* v. *New Jersey,* 251 U.S. 311, 40 S.Ct. 154 (1920); *In Re State of New York,* 256 U.S. 490, 41 S. Ct. 588 (1921); *Employees of the Department of Public Health and Welfare* v. *Missouri,* 411 U.S. 279, 93 S.Ct. 1614 (1973); *Edelman* v *Jordan,* 415 U.S. 651, 94 S.Ct. 1347 (1974), reh. den., 416 U.S. 1000, 94 S.Ct. 2414 (1974); *Dawkins* v. *Craig,* 483 F.2d 1191 (4th Cir. 1973). The state's immunity from suit without its consent, obviously, does not protect it from a suit to which it has consented. *Parden* v. *Terminal R. Co.,* 377 U.S. 184, 84 S.Ct. 1207 (1964). In attempting to present some basis for consent in this case, the Receiver chose in the District Court the implied waiver theory of *Parden* v. *Terminal R. Co., supra:*

> When a State leaves the sphere that is exclusively its own and enters into activities subject to congressional regulation, it subjects itself to that regulation as fully as if it were a private person or corporation. (At 96 U.S. 196, 84 S.Ct. 1215.)

It did not work.

1. Area of Federal Securities Laws

The "activities subject to congressional regulation" which the Receiver argues the Commonwealth entered are those activities subject to the '33 and '34 Acts although the Complaint alleges no violations of the '33 Act. The '33 Act generally requires capital attracting entities to disclose to potential investors material facts about securities to be publicly offered for the first time. Disclosure is accomplished through the filing of a registration statement which must be supplied to each purchaser at or before the sale or delivery of securities. There are severe penalties for misrepresentations and fraud. The '34 Act provides for the registration and regulation of securities exchanges, the registration of securities already issued and listed on such exchanges and certain securities traded over the counter. Its purpose is to provide fair and honest markets in securities transactions. Again there are severe penalties for fraud. See generally, *Securities and Federal Corporate Law,* Bloomenthal, Harold S. (Clark Boardman Company, Ltd., and Sage Publishers, Inc., 1972).

It is doubtful that a "Certificate of Investment" is a security under the federal securities laws.[4] Far more crucial in this case, however, is the fact that there is no allegation

[4] The district court did not have to decide this point, although it had "serious misgivings" that such was the case (App. 5a), because it was so clear there was no waiver of immunity.

that the Commonwealth offered or sold any securities nor did any act as a private person or corporation as a participant in a congressionally authorized program. See, *Edelman* v. *Jordan, supra,* 415 U.S. at 672, 94 S.Ct. at 1360. In fact, the Commonwealth never "left the sphere that is exclusively its own," *i.e.,* the regulation of industrial loan associations pursuant to the police power of the states reserved by the Tenth Amendment. Banks, savings and loan associations, and similar institutions are regulated by every state in the union and there can be no doubt that this is an area "still the primary domain of the State governments." See *Dawkins* v. *Craig, supra,* at 1195. The District Court had no trouble with this point, stating:

> Here the state was not involved in the activities of the Norfolk Savings and Loan Corporation, which were allegedly subject to federal regulation. At the most, the state's activity was limited to a regulatory system parallelling and complementing the federal regulatory scheme. (App. 10a, 11a.)

See also Federal Deposit Insurance Corporation v. *Cades,* 357 F.Supp. 1111 (E.D. Pa. 1973).

2. Governmental v. Proprietary

In considering state intervention into a congressionally regulated area, the consent issue is a matter of federal law. *Parden* v. *Terminal R. Co. supra.* Even had the Commonwealth been involved in an activity subject to federal regulation, which it was not, it must have done so as "if it were a private citizen or corporation" for the implied consent theory of *Parden* to apply. This forms the basis of the "governmental v. proprietary" distinction reflected in the case of *Employees of Dep't. of Public Health & Welfare* v.

Missouri, supra,[5] which is apparent recognition of Justice Douglas' view expressed in his dissenting opinion in *Maryland* v. *Wirtz,* 392 U.S. 183, 205, 88 S.Ct. 2017, 2028 (1968) that:

> The Court must draw the "Constitutional line between the State as government and the State as trader . . . ." *State of New York* v. *United States* [326 U.S. 572, 66 S.Ct. 310 (1946)], *supra,* at 579, 66 S.Ct. at 313.

The *Employees* case presented the specific question whether the enactment of the Fair Labor Standards Act by Congress pursuant to the Commerce Clause of the United States Constitution had ". . . brought the States to heel, in the sense of lifting their immunity from suit in a federal court . . . ."[6] In holding for Missouri, the Court refused to find such consent ". . . where the purpose of Congress . . . is not clear," stating:

> Congress acting responsibly would not be presumed to take such action silently. (411 U.S. at 284-5, 93 S.Ct. at 1618.)

This rationale followed to the letter the earlier teachings of this Court in the case of *Ford Motor Co.* v. *Department of Treasury,* 323 U.S. 459, 65 S.Ct. 347 (1945), which required a "clear indication" and "clear language" as a prerequisite to such consent.

The Petitioners had argued that the *Employees* case was controlled by *Parden* which involved a state owned railroad

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[5] The Receiver's classification of *Employees* as "purely humanitarian" (Petition, p. 10) is silly.

[6] Justice Douglas says this question was left open by *Maryland* v. *Wirtz,* 392 U.S. 183, 88 S.Ct. 2017 (1968). See, *Employees, supra,* at 411 U.S. 283, 93 S.Ct. 1617.

operating in interstate commerce and the claims of its employees arising under the Federal Employer's Liability Act. In distinguishing *Employees,* the majority explained that in *Parden* Alabama had operated the railroad "for profit" and "in the area where private persons and corporations normally ran the enterprise," and the difference in *Employees* was that

> State mental hospitals, state cancer hospitals, and training schools for delinquent girls which are not operated for profit are not proprietary. (411 U.S. at 284, 93 S.Ct. at 1617.)

The majority recognizing "how pervasive such a new federal scheme of regulation would be" (411 U.S. at 285, 93 S.Ct. at 1618) if they held that "the States surrendered their [immunity from suit in federal court] . . . when they granted Congress the power to regulate commerce,"[7] (411 U.S. at 286, 93 S.Ct. at 1619) was unable to find "a direct federal court remedy," (411 U.S. at 287, 93 S.Ct. at 1619) and declined

> . . . to extend *Parden* to cover every exercise by Congress of its commerce power, where the purpose of Congress to give force to the Supremacy Clause by lifting the sovereignity of the States and putting the States on the same footing as other employers is not clear. (411 U.S. at 286-7, 93 S.Ct. at 1619.)

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[7] In the case of *Kirschbaum* v. *Walling,* 316 U.S. 517, 520, 62 S.Ct. 1116, 1118 (1942) cited by the Court to illustrate the breadth of the Commerce Clause, it is said:

> To search for a dependable touchstone by which to determine whether employees are "engaged in commerce or the production of goods for commerce" is as rewarding as an attempt to square the circle.

This same reasoning was further strengthened and *Parden* further limited in the case of *Edelman* v. *Jordan, supra,* 415 U.S. at 673, 94 S.Ct. at 1360-1:

> Constructive consent is not a doctrine commonly associated with the surrender of constitutional rights, and we see no place for it here. In deciding whether a State has waived its constitutional protection under the Eleventh Amendment, we will find waiver only where stated "by the most express language or by such overwhelming implications from the text as will leave no room for reasonable construction." *Murray* v. *Wilson Distilling Co.,* 213 U.S. 151, 171, 29 S.Ct. 458, 464, 53 L.Ed. 742 (1909).

The District Court pointed to this Court's explanation in *Employees* that *Parden* "dealt with 'a rather isolated state activity,' the entry of a state 'for profit' into an aspect of commerce normally engaged in by private persons and corporations" (App. 8a) and that in the instant situation the Commonwealth was not engaged "in even a flavorably proprietary function." (App. 11a.) Accordingly, it held:

> Plaintiff now attempts to extend the *Parden* doctrine into the area of pure governmental regulation. Such effort, in the Court's view, must fail. The impetus toward application of the *Employees* rationale is stronger here than in the case in which it was announced. While the operation of hospitals in not necessarily a governmental function, the specific nature of the hospitals involved in *Employees* gave state activity in that area a traditional base. In the present context, the state activity attacked is necessarily of a governmental nature. Regulation of securities is not an endeavor in which private persons are free to participate. If governmental ownership of nonprofit mental hospitals is to be distinguished from governmental operation

> of a profit-making railroad, it is because the former is perceived more akin to those functions peculiarly reserved to and encumbent upon governments and closer to their essential purpose. Pure regulation of private conduct must be considered closer still. The "clear" congressional intent test announced in *Employees, supra,* must be applied here.

The implied waiver theory having thus proved unsuccessful before the District Court, the Receiver attempted to construct an additional theory of express waiver before the Fourth Circuit. He again failed but now raises it in this Court, a matter to which we briefly turn.

3. Congressional Intent

In spite of the fact that the Receiver does not allege that the Commonwealth operated this industrial loan association, issued any securities, registered any securities, nor did any act under the Securities Act,[8] he nevertheless contends that had the Commonwealth done some such act under the '33 Act, there is a clear congressional waiver of Eleventh Amendment rights in that particular Act.[9] In support of this academic contention, he cites 15 U.S.C. § 77(b)(2) which defines a "person" to be "a government or political subdivision thereof." This is the same argument that was made

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[8] Any allegation that any state official may have been guilty of fraud, which is denied, would be properly dealt with in an action against such official personally. This point was made by the district court in a second action brought by the Receiver against the Commonwealth involving the same matter. [*MacKethan* v. *Commonwealth,* Civ. No. 74-0013-R (E.D. Va. July 24,)], cited with approval by the Fourth Circuit (App. 3a) and attached hereto as Exhibit A.

[9] Of course, Section 10(b) and Rule 10(b)-5 are under the '34 Act and no contention is made that there is a clear congressional waiver under this Act.

and rejected in *Employees*[10] where it was pointed out that the Fair Labor Standards Act defined "employer" to cover "employees of a State or a political subdivision thereof, employed . . . in a hospital, institution, or school. . . ." It had previously been held in *Maryland* v. *Wirtz, supra,* that this definition brought the states under the substantive provisions of that Act, but *Employees* was unequivocal in pointing out that this definition alone was not the clear congressional expression necessary to overcome the constitutional constraints on "the judicial power" of the United States embodied in the Eleventh Amendment.

Moreover, § 17 (15 U.S.C. 77q) of the '33 Act, if it provides a private civil remedy at all, and § 10(b) [15 U.S.C. 78j(b)] of the '34 Act are court implied private civil causes of action such as were judicially molded in *J. I. Case Company* v. *Borak,* 377 U.S. 426, 84 S.Ct. 1555 (1964). *Borak* was a case which found that although there was no specific reference to a private right of action in § 14(a) of the '34 Act [15 U.S.C. § 78n(a)], such a private right of action was implied "... where necessary to make effective the congressional purpose." (377 U.S. at 433, 84 S.Ct. at 1560.) No such private action, however, will be authorized where the effect is to bring an unconsenting state into the federal court:

> And while this Court has, in cases such as *J. I. Case Co.* v. *Borak* (cit. omitted), authorized suits by one private party against another in order to effectuate a statutory purpose, it has never done so in the context of the Eleventh Amendment and a state defendant. *Edelman* v. *Jordan,* 415 U.S. at 673-4, 94 S.Ct. at 1361.

[10] Of course, in *Employees* the state was a participant in the program authorized by Congress. *Edelman* v. *Jordan, supra,* 415 U.S. at 672, 94 S.Ct. at 1360.

There is clearly no congressional expression of intent to waive the Eleventh Amendment protection in § 17 of the '33 Act or § 10(b) of the '34 Act.

B.

The Eleventh Amendment Is Absolute

The Receiver cites the cases of *Scheuer* v. *Rhodes*, 416 U.S. 232, 94 S.Ct. 1683 (1974); *Edelman* v. *Jordan, supra*, and *Dawkins* v. *Craig, supra*, for the proposition that a state's immunity is qualified thus making it inappropriate to sustain a motion to dismiss without receiving evidence as to the scope of the immunity. He is wrong. The Eleventh Amendment protection is absolute.

Scheuer v. *Rhodes* merely states that the immunity of *public officials* is not absolute but qualified, a holding consistent with prior case law and not the landmark the Receiver represents it to be. This Court went to great lengths to make clear that the rationale of that case was "... no aid to a plaintiff seeking damages from the public treasury ..." [11] but was applicable only in a case involving the personal liability of "... individual defendants ... [who] hold public office." [12] The Court was equally unequivocal in *Edelman* v. *Jordan* that:

> ... a suit by private parties seeking to impose liability which must be paid from public funds in the state treasury is barred by the Eleventh Amendment. (415 U.S. at 663, 94 S.Ct. at 1356.)

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[11] 416 U.S. at 238, 94 S.Ct. at 1687.

[12] *Id.*

Dawkins v. *Craig* is absolutely consistent in holding that "... relief [which] looks directly to the payment of public funds out of the State treasury ... is contrary to the Eleventh Amendment."[13]

It is difficult to misread these cases in the manner in which the Receiver has done. The fact that other cases may not have been decided on a motion to dismiss is of no relevance. The Receiver points out on page 11 of his Petition that the allegations of the Complaint must be taken as true for purposes of the motion to dismiss. There is nothing left for him to prove because the Commonwealth has taken every allegation as true for such purposes and the action is clearly barred by the Eleventh Amendment.

III.

CONCLUSION

This case was decided below on principles firmly entrenched in our system of jurisprudence. The Receiver's allegations do not present any foundation for a *Parden* waiver under either the '33 or '34 Acts as the Commonwealth never left the area that was exclusively her own nor entered into activities subject to congressional regulation as a private person or corporation. The State merely performed the governmental function of regulator. Furthermore, there is no "clear congressional intent" to waive the states' Eleventh Amendment protection in the federal securities laws, and especially is this so when dealing with a court implied private cause of action. The decision below was plainly right and

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[13] 483 F.2d at 1194.

no important unsettled question of federal law is presented herein. The Petition for Certiorari should be denied.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on this 17th day of April, 1975, three true and correct copies of the Brief in Opposition to Petition for Certiorari were mailed, postage prepaid, to Oren R. Lewis, Jr., Esquire, Lewis, Wilson, Cowles, Lewis & Jones, Ltd., counsel for plaintiff, 2054 North 14th Street, Arlington, Virginia 22216.

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